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Kellogg Company Q3 2008 Earnings Call Transcript

Question-and-Answer Session

Operator

(Operator Instructions) Our first question is from David Palmer with UBS. Please proceed with your question.

David Palmer UBS

One simple question, and that is about currency and the interconnection with commodities. I think this is the first time you are giving a constant currency guidance. But I am wondering how we should think about how that connects, I would assume, with commodities and the outlook for that. In other words, a stronger dollar would coincide with yearoveryear declines or a more benign outlook for commodities than perhaps you would assume if we had a weaker dollar environment. How should we think about that? On the face I would assume that you would choose to have a firm dollar and less inflation, but perhaps there's some other timing things going on here where you haven't done certain hedges on currency but you have on commodities that might be shaping your outlook for 2009.

David Mackay

I will let John take the FX and then I will come back and talk a little bit about commodities.

John Bryant

Just to clarify on foreign exchange, if we step back and look at our business, certainly the internal mid-single-digit sales growth and profit growth forecasts we gave gives you a sense that our business is doing well. But to your point, David, there's been some unprecedented moves in foreign exchange. If we think about those in two buckets, there's a transactional and a translational impact of foreign exchange. Transactional, just to use an example of we export products from the U.S. to Canada, the Canadian dollar is devalued by 20%. Obviously, a product going to Canada will cost more. That sort of impact of foreign exchange we can price away in the marketplace. The translational impact, though, of the profits in Canada now are translated at 20% less than U.S. dollars. That's something we can't price away.

If you think about the size of the translational issue that we have, if you look at the operating profit from our international business plus Canada, it's 40% to 45% of the company's total operating profit and, quite frankly, we have a lower tax rate outside the U.S. than inside the U.S. So it's more in the ballpark of 50% of net income. If we had a 10% to 20% move in foreign exchange, then you can see a 5 to 10 point impact on the EPS. So the size and magnitude of the movement is quite substantial.

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